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POSTAL RATE COMMISSION  
OFFICE OF THE SECRETARY

BEFORE THE  
POSTAL RATE COMMISSION  
WASHINGTON DC 20268-0001

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POSTAL RATE AND FEE CHANGES, 2000

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Docket No. R2000-1

REBUTTAL TESTIMONY OF  
RICHARD PATELUNAS  
ON BEHALF OF THE  
UNITED STATES POSTAL SERVICE

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Rebuttal Testimony  
of  
Richard Patelunas

AUTOBIOGRAPHICAL SKETCH

1           My name is Richard Patelunas. I am a Financial Analyst with the U. S.  
2   Postal Service and I began as a career employee in 1977. Before coming to  
3   Headquarters in 1986, I held the craft positions of city carrier, LSM Operator,  
4   distribution clerk and window clerk. Prior to that, I had several temporary  
5   appointments between 1974 and 1977.

6           I presented testimony before the Postal Rate Commission in Docket Nos.  
7   R90-1, MC93-1, R94-1, MC95-1, MC96-3, R97-1 and in this docket. I have a  
8   B.A. in Economics from the State University of New York at Binghamton (1978)  
9   and an M.B.A. from Syracuse University (1986).

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1 **I. Purpose of Testimony**

2 Witness Buc (DMA-T-1) discusses what he terms as two errors in the  
3 Postal Service's estimated test year expenses. First, he argues that he corrects  
4 a flaw in the rollforward methodology concerning the cost reduction treatment of  
5 supervisors. Tr. 22/9547-48. Second, he argues that he corrects an  
6 understatement of the savings from the AFSM 100 program. Tr. 22/9549-52.  
7 Below I show why witness Buc's analysis should be rejected.

8  
9 **II. Supervisor Cost Savings**

10 **A. Witness Buc's Mechanical Adjustment to Supervisor Costs**  
11  **Ignores Operating Reality**  
12

13 Witness Buc testifies that supervisor costs should be reduced by \$92  
14 million to maintain the pre-cost reduction program supervisor ratio. Witness Buc  
15 argues that cost reductions for clerks and mailhandlers, and city carriers should  
16 be accompanied by reductions in costs for their supervisors. Tr. 22/9547. He  
17 points out that the rollforward model adjusts supervisor costs for changes in  
18 clerk, mail handler, and city carrier costs due to mail volume and non-volume  
19 workload changes, but not for cost reductions. *Id.*

20 Maintaining the pre-cost reduction supervisor ratio is not appropriate.  
21 That ratio does not reflect the program managers' expert assessment of what  
22 supervisor savings can or can not be captured in conjunction with each distinct  
23 program. Because the introduction of automation equipment and other  
24 programs changes the configuration of postal operations, the ratio of

1 supervisors to the employees they supervise also changes. For instance, I am  
2 informed that with more machines, an on-line keying room, the speed of the new  
3 machines, the additional number of sort plans, etc., maintaining the same ratio of  
4 supervisors would mean that each supervisor would be responsible for a  
5 considerably larger portion of the flow of mail. There is, however, a limit on what  
6 each individual supervisor can be responsible for. The approach used in the rate  
7 case is consistent with the way the Postal Service's operating budgets are  
8 determined. Savings calculated by a mathematical formula, but not considered  
9 in the formulation of field budgets, will not be realized and are therefore false  
10 savings.

11       Witness Buc's proposed adjustment is improper. His method is purely  
12 mechanical, ignoring the reality that most cost reduction programs change the  
13 operating environment and result in additional supervisory complexities and  
14 responsibilities. This limits the opportunity to reduce supervisor costs in direct  
15 proportion to craft workhour savings. In fact, witness Buc agreed that supervisory  
16 workhours would only vary directly with clerk workhours in an environment where  
17 all things remain equal. Tr. 22/9595. Witness Buc further testified that "if  
18 management changes the supervisory requirements of the new operating  
19 environment, the ceteris paribus conditions will no longer hold." *Id.* I am  
20 informed by our program managers that this is in fact the case: most cost  
21 reduction programs change the operating environment and consequently, the  
22 Postal Service does not budget for proportional supervisor savings.

**B. Actual Events Provide Evidence That Witness Buc's Supervisor Argument is Invalid**

In addition to the facts outlined above, there is other compelling evidence that witness Buc's logic is flawed. The table below clearly shows that actual FY 98 supervisor costs were very close to the Postal Service's original estimates presented in the Docket No. R97-1 filing. In fact, most of the difference between those actual results and the Commission's recommended amount for supervisors in Docket No. R97-1 can be accounted for by the Buc adjustment. Witness Buc confirms that without his adjustment the Commission would have recommended \$3.521 billion supervisor costs, which is within \$9 million or 0.3% of actual supervisor costs. Tr. 22/9575. This shows clearly that both the Commission estimate without the Buc adjustment and the Postal Service's estimate in the last docket were very close to actual results, while the Buc adjusted estimate resulted in a much larger variance.

Table 1  
FY 98 Cost Segment 2  
Supervisor Costs  
\$(Millions)

	PRC Estimate	PRC Estimate <sup>1</sup>	USPS Estimate
R97-1 Rate Case	3,420	3,420	3,515
Buc Adjustment		101	
Rate Case Without Buc Adj		3,521	3,515
Actual	3,512	3,512	3,512
Over/(under)Actual	-92	-9	-3
% Over/(under) Actual	-2.6	-0.3	-0.1%

<sup>1</sup> Adjusted to remove impact of Buc adjustment on PRC estimate of supervisor costs.

1 In sum, witness Buc's adjustment should be rejected. Supervisor cost  
2 savings opportunities should be reviewed in terms of the functions, obligations  
3 and environment of supervision – not merely mechanistically piggybacked on  
4 direct labor costs. Witness Tayman's direct testimony, USPS-T-9, uses the  
5 correct approach to identify supervisor cost savings; witness Buc's testimony  
6 does not.

7

### 8 **III. AFSM 100 Savings**

9 Witness Buc contends that his calculations of the savings from the AFSM  
10 100 program are conservative estimates representing at least \$199.933 million  
11 more savings than that those calculated by the Postal Service. Far from being  
12 conservative, witness Buc's calculations rely on unrealistic and unattainable  
13 assumptions.

14 Witness Buc confirms that he ignored piggyback costs in his calculations.  
15 Tr. 22/9579. Likewise, he confirms that the AFSM 100 requires more floor space  
16 (square feet) than either the FSM 881 or the FSM 1000 and that he made no  
17 adjustments to the Postal Service's estimate of floor space. Tr. 22/9580.  
18 Additionally, witness Buc confirms that he has not included allied labor costs, Tr.  
19 22/9581. By ignoring piggyback costs, additional required floor space, and allied  
20 labor costs in his analysis, witness Buc focuses attention on only the cost  
21 savings portion of the operating environment that results from the AFSM 100.  
22 Focusing on only the cost savings portion of the environment does not result in a  
23 conservative estimate.

1 In terms of practice or implementation, witness Buc is not as conservative  
2 as he argues because his analysis rests on an ideal world where all of his  
3 assumptions are fully realized. Witness Buc confirms that his analysis assumes  
4 that the Postal Service will realize 100 percent of the Test Year cost savings that  
5 he has calculated. Tr. 22/9582. To achieve this, witness Buc assumes a  
6 deployment of 166.5 machines in the test year, Tr. 22/9588, and further assumes  
7 that each and every machine will operate twenty hours per day, six days per  
8 week. It is my understanding that this assumption is not attainable because not  
9 all Phase I machines will be deployed for the entire test year.

10 Even when all of the machines are deployed, these assumptions are  
11 unduly optimistic because they inherently assume that as the deployment of this  
12 new AFSM 100 environment evolves, change can be precisely planned for and  
13 results perfectly anticipated. Not only that, witness Buc assumes that the  
14 savings are instantaneously realized and continue uninterrupted. Witness Buc's  
15 formulaic application of a set of assumptions to an evolving deployment schedule  
16 is unrealistic. I understand that the real world operating environment faced by  
17 program managers is much more complex; for instance, there are differing  
18 facility sizes and configurations. I further understand that the mail volume  
19 needed to optimize machine utilization may not be present at all facilities. Also,  
20 the volume that does exist at a facility is currently processed on other than an  
21 AFSM 100. These variables demonstrate that the change to AFSM 100  
22 processing, and realizing the full savings, are not as easy as flipping a switch.  
23 As such, the deployment of any new program undergoes a learning curve

1 reflecting the uneven progress of implementation. It is my understanding that  
2 the program managers consider as many variables as is reasonable, given the  
3 complexity of their task, in estimating the AFSM 100 program savings used in the  
4 Postal Service's filing.

5 Furthermore, the savings used in the filing are budget savings; thus, they  
6 are the result of the Postal Service's "Catchball" process used in developing the  
7 operating budget. In this process, the savings estimated by the program  
8 managers are presented to the field, negotiations ensue and budgeted savings  
9 are agreed upon. As such, the savings have been subjected to the judgment of  
10 the field managers who must realize the savings and who are in the best position  
11 to determine their reasonableness – these are the operations managers who  
12 must move the mail. Much like the supervisor cost savings discussed earlier,  
13 savings calculated over and above the savings considered in the formulation of  
14 field budgets will not be realized and are therefore false savings.

15 Assuming that all of the assumptions are realized and 100 percent of the  
16 highest theoretically possible savings are recognized in the test year is not a  
17 conservative analysis. Witness Buc's conclusion that there are additional AFSM  
18 cost savings in the test year should be rejected because the assumptions  
19 underlying that conclusion are simply not realistic.